Tobacco Settlement Revenue Management Authority

Independent Auditors' Report

General Purpose Financial Statements
Period from August 10, 2000 (Date of Inception)
to June 30, 2001

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

TABLE OF CONTENTS

INDEPENDENT AUDITORS' REPORT

The Honorable Jim Hodges, Governor, and
Members of the Tobacco Settlement Revenue
Management Authority
State of South Carolina
Columbia, South Carolina

We have audited the accompanying general purpose financial statements of the Tobacco Settlement Revenue Management Authority (the "Authority") as of June 30, 2001, and for the period from August 10, 2000 (date of inception) to June 30, 2001. These general purpose financial statements are the responsibility of management of the Authority. Our responsibility is to express an opinion on these general purpose financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the financial statements of the Authority are intended to present the financial position and results of operations of only that portion of the funds and account groups of the State of South Carolina that is attributable to the transactions of the Authority, a component unit of the State. These statements do not include other agencies, institutions, departments or component units of the State of South Carolina primary government.

The Authority elected not to present a statement of revenues, expenditures, and changes in fund balance - budget and actual for the general fund for the year ended June 30, 2001. Presentation of such a statement for those governmental funds for which budgets have been legally adopted is required by accounting principles generally accepted in the United States of America.

In our opinion, such general purpose financial statements present fairly, in all material respects, the financial position of the Authority at June 30, 2001, and the results of its operations for the period from August 10, 2000 (date of inception) to June 30, 2001 in conformity with accounting principles generally accepted in the United States of America.

Deloitte + Touche LLP

October 29, 2001

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

COMBINED BALANCE SHEET
JUNE 30, 2001

ASSETS AND OTHER DEBITS	Governmental Fund Types General	Account Group General Long-Term Obligations	Total "Memorandum Only"
CASH AND CASH EQUIVALENTS (Note 3)	$ 154,938	$ -	$ 154,938
INVESTMENTS (Note 3) - Restricted	124,539,527	-	124,539,527
ACCRUED INTEREST RECEIVABLE	1,877,486	-	1,877,486
AMOUNT TO BE PROVIDED FOR GENERAL LONG-TERM OBLIGATIONS	-	934,530,000	934,530,000
TOTAL ASSETS AND OTHER DEBITS	$ 126,571,951	$ 934,530,000	$ 1,061,101,951
LIABILITIES AND FUND BALANCE			
LIABILITIES - Bonds payable (Note 4)	$ -	$ 934,530,000	$ 934,530,000
Total liabilities	-	934,530,000	934,530,000
FUND BALANCES:			
Reserved for debt service	124,539,527	-	124,539,527
Unreserved	2,032,424	-	2,032,424
	126,571,951	-	126,571,951
TOTAL LIABILITIES AND FUND BALANCE	$ 126,571,951	$ 934,530,000	$ 1,061,101,951

See notes to general purpose financial statements.

TOBACCO SETTLEMENT REVENUE MANAGEMENT AUTHORITY

COMBINED STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES PERIOD FROM AUGUST 10, 2000 (Date of Inception) TO JUNE 30, 2001

	Governmental Fund Types
	General
REVENUES - Investment income	$ 1,877,486
EXPENDITURES - Current:	
Bond issuance costs	2,337,629
Insurance	2,050
Bond underwriting fees	8,292,886
Total expenditures	10,632,565
REVENUES UNDER EXPENDITURES	(8,755,079)
OTHER FINANCING SOURCES (USES):	
Transfer from primary government	75,000
Transfers to primary government	(785,825,514)
Proceeds from issuance of bonds (net of discount of $13,452,456)	921,077,544
Total other financing sources	135,327,030
EXCESS OF REVENUES AND OTHER FINANCING SOURCES OVER EXPENDITURES AND OTHER FINANCING USES	126,571,951
FUND BALANCE, JUNE 30, 2001	$ 126,571,951

See notes to general purpose financial statements.

1. REPORTING ENTITY

The Tobacco Settlement Revenue Management Authority (the "Authority") is a public body and an instrumentality of the State of South Carolina (the "State") established pursuant to Section 11-49-30 of the South Carolina Code of Laws as amended.

The core of the financial reporting entity is the primary government which has a separately elected governing body. As required by generally accepted accounting principles, the financial reporting entity includes both the primary government and all of its component units. Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. In turn, component units may have component units.

An organization other than a primary government may serve as a nucleus for a reporting entity when it issues separate financial statements. That organization is identified herein as a primary entity. The Authority has determined it has no component units and the financial reporting entity includes only the Authority (a primary entity).

A primary government or entity is financially accountable if its officials or appointees appoint a voting majority of an organization's governing body including situations in which the voting majority consists of the primary entity's officials serving as required by law (e.g., employees who serve in an ex officio capacity on the component unit's board are considered appointments by the primary entity) and (1) it is able to impose its will on that organization or (2) there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary entity. The primary entity also may be financially accountable if an organization is fiscally dependent on it even if it does not appoint a voting majority of the board. An organization is fiscally dependent on the primary government or entity that holds one or more of the following powers:

(1) Determines its budget without another government's having the authority to approve and modify that budget.

(2) Levies taxes or sets rates or charges without approval by another government.

(3) Issues bonded debt without approval by another government.

The organization is fiscally independent if it holds all three of those powers. Based on these criteria, the Authority has determined it is not a component unit of another entity and it has no component units. This financial reporting entity includes only the Authority (primary entity).

The Authority is a component unit of the primary government of the State as defined in the Government Accounting Standards Board ("GASB") Statement No. 14, *The Financial Reporting Entity*. Accordingly, the financial statements are included as a blended component unit in the State's special revenue fund in the Comprehensive Annual Financial Report, of the State of South Carolina.

The Authority is governed by a board, which consist of five members. The members are the Governor or his designee, the State Treasurer, the Comptroller General, the Chairman of the Senate Finance Committee and the Chairman of the House Ways and Means Committee. The Governor serves as chairman; in the absence of the Governor, the meeting must be chaired by the State Treasurer. All members of the Board serve ex-officio.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General - In its accounting and financial reporting in conformity with accounting principles generally accepted in the United States of America, the Authority follows the pronouncements of the GASB.

Basis of Accounting and Measurement Focus **-** The accounts of the government are organized and operated on the basis of funds and accounts. A fund is an independent fiscal and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with financial-related legal and contractual provisions. The accounting and financial reporting treatment applied to a fund is determined by its measurement focus.

Governmental funds are accounted for using the current financial resources measurement focus and the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized in the accounting period in which they become susceptible to accrual, (i.e., both measurable and available to finance expenditures of the fiscal period). Expenditures are recognized in the accounting period in which the fund liability is incurred, except for unmatured interest on general long-term debt which is recognized when due, if measurable.

Basis of Presentation - The financial transactions of the Authority are recorded in an individual fund and an account group. The various fund and account group are reported by type in the financial statements.

The Authority uses the following fund type and account group:

Governmental Funds - The General Fund is used to account for all financial resources associated with the Authority except for those required to be accounted for in another fund.

General Long-Term Obligation Account Group - The account group is used to establish accounting control and accountability for general long-term obligations.

Cash and Cash Equivalents - Cash includes cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date acquired by the Authority.

Investments - Investments are recorded on the balance sheet at fair value and all investment income, including changes in the fair value of investments, is reported as revenue in the statement of operations.

Restricted Assets - The bond indenture states that the Trustee shall establish and maintain the following segregated trust accounts in the Issuer's name: (1) the Collections Account; (2) the Debt Service Account; (3) the Partial Lump Sum Payment Account; (4) Liquidity Reserve Account; and (5) the Turbo Redemption Account.

The Liquidity Reserve Account is funded from proceeds of the issuance of the Series 2001 Term Bonds in an amount equal to $85,923,059, which is equal to maximum annual debt service on the Series 2001 Term Bonds as of their date of issuance, based on the assumption that all sinking fund installments are paid when due. The Authority is required to maintain this balance in the Liquidity Reserve Account, to the extent of available funds.

Amounts on deposit in the Liquidity Reserve Account will be available to pay term bond maturities and sinking fund installments of, and interest on, the Series 2001 Term Bonds to the extent collections are insufficient for such purpose. Any amount remaining after such payments in excess of the Liquidity Reserve Requirement will be deposited in the "Collection Account." Unless an event of default has occurred, amounts withdrawn from the Liquidity Reserve Account will be replenished from collections.

Within the Debt Service Account, there is an Interest Reserve Subaccount. The balance of the Interest Reserve Subaccount at June 30, 2001 is $38,616,468. The balance in the Collections Account, the Partial Lump Sum Payment Account and the Turbo Redemption Account at June 30, 2001 is zero.

Administrative Expenses - The State of South Carolina performs certain accounting, legal and administrative services for the Authority for which it receives no compensation. The value of such service was immaterial to the Authority's financial statement.

Revenues and Expenditures - Revenues and expenditures are recorded on the modified accrual basis of accounting.

Budgetary Information - Section 11-49-60 of the Code of Laws requires the Authority to adopt an annual budget. Annual budgets are to be adopted on a basis consistent with generally accepted accounting principles for all governmental funds. The Authority's board adopted a budget that provided for $75,000 of costs associated with the operation and administration of the Authority. Based on the nature of the budget and the fact that fiscal 2001 was the initial year of operations, the Authority elected not to present a statement of revenues, expenditures and changes in fund balance - budget and actual for the general fund for the year ended June 30, 2001. Presentation of such a statement for those governmental funds for which budgets have been legally adopted is required by accounting principles generally accepted in the United States of America.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. DEPOSITS AND INVESTMENTS

At June 30, 2001, the Authority's deposits and investments consisted of the following:

Description	Maturity Date	Fair Value and Reported Value June 30, 2001
Cash and cash equivalents - cash on deposit		$ 154,938
Total		$ 154,938
Investments:		
Federal National Mortgage Association	11/15/2001	$ 38,616,468
Federal Home Loan Mortgage Corporation	11/21/2001	85,923,059
Total		$124,539,527

Deposits - Most deposits are under the control of the State Treasurer who, by law, has sole authority for investing State funds. State law requires full collateralization of all State Treasurer bank balances. The State Treasurer must correct any deficiencies in collateral within two days. At June 30, 2001, all State Treasurer bank balances were fully insured or collateralized with securities held by the State.

Investments - The Authority's investment policy provides for eligible investments in obligations of FHLMC, FNMA, or Federal Farm Credit System, demand and time deposit accounts and certificates of deposit, general obligations of states and guaranteed state obligations, commercial or finance company paper, repurchase obligations, corporate securities bearing interest or sold at discount, taxable money market funds, investment agreements or guaranteed investment contracts, and other obligations or securities that are investment agreements or guaranteed investment contracts and other obligations or securities that are non-callable.

The Authority's investments are categorized to give an indication of the level of risk assumed by the entity at year-end. The credit risk categories are concerned with custodial credit risk, which is the risk that a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party if the counterparty to the investment transaction fails. There are three categories of credit risk. Category 1 includes investments that are insured or registered or for which the securities are held by the entity or its agent in the Authority's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the Authority's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty or by its trust department or agent but not in the Authority's name. The Authority's investments are held by the Trustee in several restricted accounts in the name of the Authority. All investments of the Authority at June 30, 2001 are in Risk Category 1.

4. BONDS PAYABLE

On March 22, 2001, the Authority issued asset-backed bonds pursuant to an indenture between the Authority and United States Trust Company of New York, as trustee, dated as of March 1, 2001 (the "Indenture"). The State transferred to the Authority all of its rights and interests under the Master Settlement Agreement (the "MSA") and the Consent Decree and Final Judgment (the "Decree"). These rights include the State's share of all Tobacco Settlement revenues received after June 30, 2001 and in perpetuity to be received under the MSA. The consideration paid by the Authority to the State for such rights consisted of $785,750,514 cash. Also, the State (primary government) transferred $75,000 to the Authority to finance initial activities prior to the issuance of the bonds. The Authority's rights to receive Tobacco Settlement Revenues is its most significant asset and is expected to produce funding for all of its obligations.

The MSA is an industry-wide settlement of litigation between the Settling States and the Original Participating Manufacturers ("OPMs") and was entered into between the attorneys general of the Settling States and the OPMs on November 23, 1998. The MSA provides for other tobacco companies, referred to as Subsequent Participating Manufacturers (the "SPMs"), to become parties to the MSA. The four OPMs together with the 25 SPMs are referred to as the Participating Manufacturers ("PMs"). The settlement represents the resolution of a large potential financial liability of the PMs for smoking-related injuries, the costs of which have been borne and will likely continue to be borne by cigarette consumers. Pursuant to the MSA, the Settling States agreed to settle all their past, present and future smoking-related claims against the PMs in exchange for agreements and undertakings by the PMs concerning a number of issues. These issues include, among others, making payments to the Settling States, abiding by more stringent advertising restrictions and funding educational programs, all in accordance with the terms and conditions set forth in the MSA. Distributors of PMs' products are also covered by the settlement of such claims to the same extent as the PMs.

In 2001, the Authority issued $934,530,000 of Tobacco Settlement Asset-Backed Bonds, consisting of $200,000,000 Series 2001A (Taxable) Term Bonds and $734,530,000 Series 2001B (Tax-Exempt) Term Bonds (collectively, the "Series 2001 Term Bonds"). The Series 2001 Term Bonds were issued by the Authority pursuant to an Indenture between the Authority and United States Trust Company of New York, as trustee, dated as of March 1, 2001.

The payment of the Series 2001 Term Bonds is dependent on the receipt of Tobacco Settlement Revenues ("TSRs"). The amount of TSRs actually collected is dependent on many factors, including cigarette consumption and the continued financial capability of the Original Participating Manufacturers ("OPMs"). Such bonds are secured by and payable solely from TSRs and investment earnings pledged under the Bond Indenture and amounts established and held in accordance with the Bond Indenture.

The Series 2001 Term Bonds are payable only from the assets of the Authority. In the event that the assets of the Authority have been exhausted, no amounts will thereafter be paid on the Series 2001 Term Bonds. The Series 2001 Term Bonds are not legal or moral obligations of the State, and no recourse may be had thereto for payment of amounts owing on the Series 2001 Term Bonds. The Authority's only source of funds for payments on the Series 2001 Term Bonds are the TSRs. The Authority has no taxing power.

Long-Term Debt is composed of the following:

2001 Series A (Taxable) Term Bonds due May 15, 2016 with interest of 7.666% due semi-annually on May 15th and November 15th, commencing on November 15, 2001	$200,000,000
2001 Series B (Tax-Exempt) Term Bonds due May 15, 2022 with interest of 6% due semi-annually on May 15th and November 15th, commencing November 15, 2001	225,880,000
2001 Series B (Tax-Exempt) Term Bonds due May 15, 2028 with interest of 6.375% due semi-annually on May 15th and November 15th, commencing November 15, 2001	347,265,000
2001 Series B (Tax-Exempt) Term Bonds due May 15, 2030 with interest of 6.375% due semi-annually on May 15th and November 15th, commencing November 15, 2001	161,385,000
	$934,530,000

The "sinking fund installment" of a Series 2001 Term Bond represents the amount of principal that the Authority will pay as of the specified distribution date (each, a "sinking fund payment date") from collections and, if necessary, the Liquidity Reserve Account.

A failure by the Authority to pay the sinking fund installment of a Series 2001 Bond on its applicable sinking fund installment payment date will not constitute an event of default under the Indenture. However, a failure to pay interest on the Series 2001 Term Bonds when due or principal of the Series 2001 Term Bonds by their maturity dates will constitute an event of default under the Indenture.

"Turbo Redemptions" represent the requirement contained in the Indenture to apply 100% of all collections that are in excess of the requirements in the Indenture for the funding of the operating expenses, the deposits to the "Debt Service Account" for the funding of interest, sinking fund installments and term bond maturities, maintenance of the Liquidity Reserve Account and the "Operating Contingency Account" (such excess, "surplus collections"), to the redemption of Series 2001 Term Bonds on each distribution date (each, a "Turbo Redemption Date") in ascending order of maturity. Such surplus collections will be deposited in an account established and maintained by the Trustee under the Indenture (the "Turbo Redemption Account"). Turbo Redemptions will be credited against sinking fund installments for any particular Series 2001 Term Bond in ascending order of sinking fund installment dates. Turbo Redemptions are not scheduled amortization payments and are to be made only from surplus collections, if any, and from amounts on deposit in the "Partial Lump-Sum Payment Account" with confirmation from each rating agency that no rating then in effect, with respect to the Series 2001 Term Bonds, from such rating agency will be withdrawn, reduced or suspended. Amounts in the Liquidity Reserve Account will not be available to make Turbo Redemptions.

The Authority debt service requirements based upon required sinking fund and interest payments are as follows:

	Sinking Fund Payments	Interest	Total Debt Service
Twelve months ended June 30:			
2002	$ -	$ 61,311,238	$ 61,311,238
2003	9,205,000	60,958,410	70,163,410
2004	1,015,000	60,566,677	61,581,677
2005	1,085,000	60,486,184	61,571,184
2006	6,215,000	60,206,375	66,421,375
Thereafter	917,010,000	909,911,364	1,826,921,364
	$934,530,000	$1,213,440,248	$2,147,970,248

5. CONTINGENCIES

The IRS is currently examining certain tobacco settlement revenue bond and securitization transactions completed to date. The IRS may determine in any of the earlier transactions that interest on the bonds issued with respect thereto is includable in gross income for federal income tax purposes. Such determination could affect the exclusion of interest on the Series 2001 Term Bonds for federal income tax purposes.

Certain smokers, consumer groups, cigarette manufacturers, cigarette importers, cigarette distributors, native American tribes, taxpayers, taxpayers' groups and other parties have instituted litigation against various tobacco manufacturers, including the PMs, as well as certain of the Settling States and other public entities. The lawsuits allege, among other things, that the MSA violates certain provisions of the United States Constitution, state constitutions, the federal antitrust laws, federal civil rights laws, state consumer protection laws and unfair competition laws, certain of which actions, if ultimately successful, could result in a determination that the MSA is void or unenforceable. The lawsuits seek, among other things, an injunction against one or more of the Settling States from collecting any monies under the MSA and barring the PMs from collecting cigarette price increases related to the MSA and/or a determination that the MSA is void or unenforceable. In addition, class action lawsuits have been filed in several federal and state courts alleging that under the federal Medicaid law, any amount of tobacco settlement funds that the Settling States receive in excess of what they paid through the Medicaid program to treat tobacco-related diseases should be paid directly to Medicaid recipients. To date, no such lawsuits have been successful. The enforcement of the terms of the MSA may, however, continue to be challenged in the future. In the event of an adverse court ruling, the Authority may not have adequate financial resources to make payment on the Series 2001 Term Bonds.

* * * * * * * * *